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Etceteras . . .

Truth and Freedom in Economic Analysis and Economic Policy Making

ROBERT HIGGS

For thousands of years, philosophers have told us that if we are to live our lives at their best, we should seek truth, beauty, and goodness. Of course, each of these qualities has raised thorny issues and provoked ongoing arguments. That people have carried on such arguments, rather than surrendering themselves to their raw appetites and animal instincts, may be counted a valuable thing in itself, but a final resolution of such deep questions may lie beyond human capacities.

In regard to goodness and beauty, I have nothing worthwhile to add to the discussion. For guidance in seeking goodness, we may look to saints, theologians, moral philosophers, and moral exemplars of our own acquaintance. For demonstrations of beauty, we may turn to nature and to artists, great and small, who have adorned our lives with the grace of music, poetry, and the visual arts. My own professional qualifications, as an economist and an economic historian, do not equip me to contribute anything of value in these areas.

I do feel qualified, however, to speak in regard to truth, because the search for truth has always served as the foundation of my intellectual endeavors. Moreover, my study, research, and reflection within my own professional domains have brought home to me a relationship that others might do well to ponder and respect—a relationship, indeed, an array of relationships, between truth and freedom, such that *anyone who seeks the triumph of truth must also seek to establish freedom in human affairs*.

When I began my academic career in 1968, my research specialty was the economic history of the United States. I was expected to publish the findings of my research in reputable professional journals. For a young man just beginning to master his field, carrying out publishable research was a daunting task. Thousands of other writers had already contributed to building up the literature in my field,

so adding something of enough importance to merit its publication in a good journal was hardly an easy task.

I discovered, however, that one way to proceed was by identifying significant mistakes in the existing literature and correcting them. Moreover, I soon found that many such mistakes had been made. To put this statement in another way, I found that the existing sources often failed to tell the truth about one thing or another, and in some cases the falsehoods propounded by one writer led later writers, who relied on those false statements, to make additional errors of their own. We often think of the scientific or scholarly enterprise as a cooperative process in which the establishment of one truth facilitates the establishment of another, but, unfortunately, the process often works in an adverse way, too, as the establishment of one falsehood fosters the establishment of another.

The errors in my fields of study and research take two main forms: factual and interpretive.

Factual errors arise on a few occasions from deliberate falsification, but they arise far more often from sloppiness in the observation, measurement, transcription, and processing of data. In checking quotations, for example, I often found discrepancies between the words quoted by a writer and the words appearing in the source from which the quotation was taken: some words or punctuation marks were omitted, or other words or punctuation marks were inserted, without any indication being given of such changes. Many writers are simply not careful and therefore make false statements of fact.

For example, I found that in a well-regarded article the increase in U.S. cotton production in the United States between 1850 and 1860, compared to that between 1860 and 1880—an essential fact for the argument being made—had been measured with a large error in part because the original researchers had assumed that a bale of cotton contained the same amount of lint at each of these three dates, whereas the amount of lint per bale had actually increased from 400 pounds in 1850, to 445 pounds in 1860, to 453 pounds in 1880. The researchers had made false statements of fact because they had incorrectly assumed that in the years under consideration a “bale” had signified a constant unit of weight, whereas in fact this unit of measurement had varied over time. (See Robert McGuire and Robert Higgs, “Cotton, Corn, and Risk in the Nineteenth Century: Another View,” *Explorations in Economic History* 14 [April 1977]: 169.)

On another occasion, while reviewing a major book by a professor at a leading university, I discovered that whereas the author’s findings hinged on simulations derived from a system of simultaneous equations, one of the equations was expressed in a nonsensical form that required incomparable units (physical quantities and dollar values) to be added, and another equation was expressed in a form that produced negative values that made no economic sense. Disturbed by these discoveries, I called the author on the telephone to ask him about the errors. He was surprised by my “careful reading,” but he did not seem to be especially crestfallen.

Seemingly at a loss to explain how such gross errors got into his book, he assured me that although they were undeniably in the text, they had not been present in the equations he actually used to make his hundreds of simulations. Because I could not see how his equation system could have been altered to make it complete and internally consistent without radical reformulation, I retained a deep suspicion that his big book was nothing more than a monument to the GIGO principle—garbage in, garbage out. (See Robert Higgs, review of *Late Nineteenth-Century American Development: A General Equilibrium History*, by Jeffrey G. Williamson, *Agricultural History* 49 [October 1975]: 690-92.)

Interpretive errors arise when researchers either apply an unsound theory or apply a sound theory incorrectly in their interpretation of causal relationships. This sort of mistake is much more complex and difficult to resolve than a factual error. Researchers need to master the theory appropriate for application in the area they seek to understand. Honest researchers often disagree about which theories are sound and which are unsound. Many modern economists, for example, proceed as if the role of theory in economics were the same as the role of theory in physics and chemistry. Despite this assumption's wide acceptance, it is incorrect; it fails to take into account the difference between human choices and the movements of molecules, atoms, and subatomic particles; the difference between the action of conscious, purposive beings and the behavior of unconscious, purposeless material particles and electrical currents. The positivist assumption that a single explanatory scheme—materialist reductionism—is equally applicable in all sciences is the overarching error that F. A. Hayek called *scientism*. Hayek's mentor Ludwig von Mises argued at length in many of his writings against scientism and in favor of methodological dualism (see, for example, *Theory and History: An Interpretation of Social and Economic Evolution* [New Haven: Yale University Press, 1957]).

In my career in academia, however, I discovered to my dismay that many of my colleagues had little interest in the search for truth, however one might understand or pursue it. For them, their research and publication amounted to a game in which the winning players receive the greatest rewards in salary, research funding, and professional acclaim. They understood that because of cloistered academic inbreeding, economists at the most prestigious universities consider the “smartest guys” to be those who employ the most advanced, complex, and incomprehensible mathematics in their “modeling” and “empirical testing.” I observed colleagues who became excited by their discovery of a mathematical theorem that had never been applied in economic research. These economists would look around for a plausible way to use the newly discovered mathematical theorem, to give it the appearance of economic relevance. In this way, mere technique drove research and publication. These economists did not consider, or care, whether the theorem would assist them in the discovery of economic truth; they cared only about showing off their analytical powers to impress their technically less proficient colleagues and journal editors. These colleagues, unfortunately, often did feel intimidated by the authors of articles they could not understand

because they did not know the mathematical techniques employed in the exposition. This entire enterprise, which continues even now, consumes valuable time and brain-power in a misguided carnival of intellectually irrelevant one-upmanship.

When we move from the realm of economic research to the realm of economic policy making, we encounter even more destructive falsehoods. Much modern economic theory, for example, has been used to justify government intervention in the free-market process. We might pause to reflect that this process, which operates as a price system or, seen in another perspective, as a profit-and-loss system, is simultaneously a way of revealing the truth. Thus, for example, a price established on the free market communicates true information to all potential market participants about the exchange value of a good or service relative to other goods and services. If the government places an excise tax on a good, thereby diminishing the quantity demanded and raising the market price, potential buyers then react to a false signal of the good's true exchange value. If the government pays a subsidy to a good's producers, thereby increasing the quantity supplied and lowering the market price, potential suppliers then react to a false signal of the good's true exchange value. In both cases, changes in the amounts produced give rise to corresponding changes in the amounts of various inputs demanded; and those changes give rise to other market changes; and so on, as the effects of a single government intervention in the market price system ripple outward from their source.

(Those who have studied a little economics in a university may object that according to the theory of "market failure," various deviations from hypothetical "perfectly competitive" conditions may cause market-determined prices to be distorted and outputs to be "inefficient," and in this event the government can intervene with taxes, subsidies, and regulations to bring the market into an efficient configuration. What these students probably were *not* taught, however, is that this theory *assumes* a great deal that cannot be known by anyone except as it is determined in actual markets. Further, because the actual parameters of demand, cost, and supply functions are unknown [and constantly subject to change] in the real world, the government does not, indeed, cannot know *how much* to intervene—what amount of tax to collect or how much to pay as a subsidy, for example. Further still, this theory implicitly assumes that the interventionist actions the government takes are themselves without costs. One wonders: how are the tax-and-subsidy agencies and the regulatory bureaucracies supported? Even further still, because in reality such interventions are the creations not of genuine economic experts [themselves helpless enough], but of politicians and their lackeys, the interventions are normally intended to, and do, serve not the purpose of establishing an efficient allocation of resources, but the purpose of promoting the politicians' personal, ideological, and political ends. The entire apparatus of the theory of market failure is a sheer blackboard fantasy, an economic theorist's plaything that has been accepted far too often as a helpful guide to, or justification of, government intervention in the market economy by putatively public-spirited legislators and regulators.)

In reality, the market system tends to foster an efficient allocation of resources—it constantly creates incentives for resource owners to direct their resources away from areas in which those resources have lesser value and toward areas in which they have greater value. Taxes, subsidies, and other government intrusions in the market process in effect falsify the price “signals” that guide market participants in their decisions about how much to buy, how much to sell, how to produce, where to produce, and exactly when to take various actions. If false prices should become established in a free-market system—if, for example, the price of gasoline in one town became greater than the price in a neighboring town by an amount greater than the cost of transporting a gallon of gasoline from one town to the other—entrepreneurs would have an incentive to move the product to the place at which it has a greater value. In doing so, they would cause the lower price to become higher, and the higher price to become lower, and they would move the market toward an efficient allocation of resources. Those old enough to remember the so-called energy crises of the period from 1973 to 1981 in the United States will appreciate immediately how poorly the market system works when such price changes and resource reallocations are forbidden.

Government interference in the price system blunts or destroys the incentives that would otherwise lead entrepreneurs to reallocate resources more efficiently. Taxes destroy the incentive to produce more of certain goods that, without the tax, would be profitable to produce. Subsidies create the incentive to produce more of certain goods that, without the subsidy, would be unprofitable to produce. Taxes and subsidies, and likewise regulations in various more complex ways, distort the true information inherent in the free market’s pricing process. By responding to the false prices of a government-distorted market system, entrepreneurs may enrich themselves, but only at the greater expense of the economy as a whole, not to mention the sacrifice of economic freedom inherent in the government’s coercive tax-and-subsidy system.

In this connection, we should recognize that interest rates are key relative prices, and hence government or central bank actions that push interest rates above or below their free-market levels are another way to suppress the truth about economic conditions. Artificially altered interest rates, indeed, are perhaps the most important form of falsification in economic life because they play a key role in inducing the malinvestments whose inevitable bankruptcy heralds the onset of economic busts, creating pervasive economic losses, unemployment of capital and labor, and human suffering that would not have occurred if only the government and the central bank had refrained from interfering in the market’s price-setting process.

* * *

In both the realm of economic research and the realm of economic policy, freedom is an essential condition for the generation of truth and thus for the enhanced enjoyment of social life that depends on making use of true, rather than false, information.

The academic world of the show-off, pyrotechnic economists who dominate today's mainstream profession would be impossible without the vast government subsidies that support these economists and the institutions in which they concoct their wizardry. Given a choice, consumers would not buy their glitzy but worthless research reports. The funds that support this superficially impressive intellectual showmanship must be extorted from taxpayers by threatening them with fines and imprisonment.

In similar fashion, the grossly distorted economy in which—to take but one example among thousands—ethanol producers and corn farmers are enriched at the expense of the direct and indirect consumers of corn throughout the world would be impossible without the huge subsidies and government mandates that have brought the biofuel industry to its present size and configuration. Without the various forms of taxes borne by producers today, many valuable goods and services would be supplied in enormously greater quantities. Work, saving, investment, and technological progress would be much greater and economic growth much faster in a world that relied on true information about relative exchange values, rather than on the false signals brought into being by the government's coercive, politically inspired intrusions.

In economics, as in other areas of life, the pursuit and exploitation of truth depend on freedom. Every cognizant adult knows that virtually all politicians are habitual liars. Too few of us understand, however, that the free market itself is a grand generator of truth, and that, in general, government intrusion of any kind operates to substitute falsehood for this truth, with devastating consequences for the genuine flourishing of human beings in their social and economic lives.

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